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ISS Releases Its 2019 Policy Survey Questionnaire

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EVA To Officially Become Part of the Pay-for-Performance Analysis

Institutional Shareholder Services (ISS) recently issued its policy survey questionnaire, which previews potential changes in ISS's voting policies for the upcoming proxy season in 2020. Through this annual policy survey, ISS seeks feedback from institutional investors, public companies, corporate directors, and the consulting and legal communities on emerging trends in corporate governance, executive compensation, and other matters as part of its policy formulation process. The policy survey often provides an advance read on where ISS is heading on a particular issue.

In a change from recent years, this year's questions will be posed within a single survey with only a limited number of questions. The survey will be open for participation until August 9, 2019 at 5:00 pm ET and can be completed online here. The results of the survey are expected to be published in late September.

After analysis and consideration of the survey responses and other inputs, ISS will then issue draft policies, open a public comment period for all interested market participants, and subsequently issue final policies by year-end.

We believe the most pertinent questions with respect to US or global policies impacting compensation and corporate governance matters include the following four topics:

1. Economic Value Added in Financial Performance Assessment Screen (US and Canada)

Currently, ISS's pay-for-performance evaluation generally includes a quantitative analysis comparing CEO total pay and company performance, as measured in absolute terms, as well as relative to an ISS-constructed peer group using three tests. A company assigned a "medium" level of concern from the three core tests can be taken down to a "low" if it

excels in the Financial Performance Assessment (FPA) screen. Conversely, a company with a “low” level of concern from the three core tests can be taken to a “medium” if it performs poorly in the FPA screen. For purposes of the FPA test, ISS measures financial performance based on the three-year weighted average of three or four of the GAAP-based financial metrics.

Last year, ISS considered changing this methodology for assessing CEO pay and performance by supplementing or replacing existing GAAP-based accounting metrics in the FPA with Economic Value Added (EVA)-based metrics to measure corporate economic performance. However, ISS ultimately decided to table incorporation of EVA into FPA for 2019. Instead, it simply displayed EVA measures in its 2019 reports on a stand-alone basis with no impact on the FPA analysis.

The survey indicates that ISS now plans to incorporate EVA metrics into the FPA screen in the 2020 proxy season. It notes that initial feedback from some investor clients in 2018 indicated that in the event of the use of EVA metrics in this manner, they would find it useful for ISS to continue to display the prior-used GAAP metrics separately as a point of comparison.

The survey asks participants which of the following best describes its organization's viewpoint on this issue, with the options being:

- *The prior-used GAAP-based metrics should be displayed below the FPA screen in the report as a point of comparison*
- *Display of the prior-used GAAP-based metrics is unnecessary*
- *Other (please specify)*

Pearl Meyer Observation: While we have had notice for over a year that EVA would eventually be incorporated into the pay-for-performance analysis, most of our clients have not considered EVA as a performance measure. Of course, it is hard to ignore that this change was bound to become official sooner rather than later with ISS having acquired EVA Dimensions, a company that provides EVA consulting services.

2. Gender Diversity on Boards (Global and US)

Under US policy guidelines ISS will recommend voting against the nominating committee chair (or other members as appropriate) at Russell 3000 and/or S&P 1500 companies that do not have at least one woman on the board. Mitigating factors that will be considered before a negative recommendation is made will include (1) a firm commitment, as stated in the company's proxy statement, to appoint at least one woman to the board in the near term, such as within the next year, (2) the presence of at least one woman on the board at the time of the preceding annual meeting, and (3) other relevant mitigating factors on a case-by-case basis if applicable.

The survey contains several questions on the issue of board gender diversity, as follows:

In general, which of the following statements best reflects your organization's view on the importance of gender diversity on the boards of companies (asked on a global level)?

- *Board gender diversity is an essential attribute of effective board governance regardless of the company, or of the market where a company is incorporated or lists its shares.*
- *Board gender diversity is an issue that should be examined on a market-by-market basis to determine if the company's boardroom recruitment practices appear to be significantly out of step with the laws, listing standards, or code of best practice of the market where it is incorporated or lists its shares with respect to gender diversity.*
- *Gender diversity in the boardroom is best addressed at the company level rather than on a global or market basis and the analysis should include factors such as firm's market cap, industry sector, and the laws, listing standards, or code of best practice of the market where it is incorporated or lists its shares.*
- *Board gender diversity is not a significant factor that should be considered.*
- *Other (please specify)*

Specific to US companies, the policy survey asks the following questions:

Would your organization consider other mitigating factors to be sufficient to avoid a negative ISS recommendation on directors?

- *Yes*
- *No*
- *It depends (please specify)*

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- *Yes*
- *No*
- *It depends (please specify)*

If you answered “Yes” or "It depends" to the above question, what other mitigating factors would you consider to be sufficient? (Check all that apply)

- *The company's commitment to include one or more women in its pool of candidates whenever it looks to add a new director to the board (sometimes referred to as the "Rooney rule”)*
- *The company's commitment to conduct an active search to add women to the board, regardless of whether there is a current vacancy on the board*
- *Other (please specify)*

Pearl Meyer Observation: It is interesting that ISS continues to seek investor input on the importance of gender diversity even after ISS adopted a gender diversity policy, at least in the US. Perhaps questions about mitigating circumstances indicates ISS’s intention to refine its policy this year.

3. Combined CEO/Chair (US)

ISS notes that the debate over the proper board leadership structure continues, especially in the US where many market participants agree in principle on the need for independent board leadership but disagree as to whether a lead independent director is an acceptable alternative to an independent board chair. ISS’s US policy recommends generally supporting shareholder proposals requesting that the position of board chair be filled by an independent director, after taking into consideration a wide variety of factors.

On this note, the survey asks which factors or circumstances would most strongly suggest the need for an independent board chair in the face of a shareholder proposal seeking an independent chair?

- *A weak or poorly-defined lead director role*
- *Governance practices that weaken or reduce board accountability to shareholders (e.g., a classified board, plurality vote standard, inability of shareholders to call a special meeting, lack of a proxy access right)*
- *Lack of board refreshment or board diversity*
- *Poor responsiveness to shareholder concerns*
- *Long-term underperformance of the company relative to peer companies*
- *Scale/complexity of the business (that is, a larger or more complex business indicating a greater need for stronger separation of the leadership roles)*
- *Excessive or poorly structured executive compensation*
- *A corporate crisis (e.g., a serious regulatory scandal, security breach, accounting scandal, or product/operational failure)*
- *Other (please specify)*

Pearl Meyer Observation: While ISS continues to push for separation, many filers have come to the conclusion that separation is not necessary. Perhaps ISS is considering softening its position in some situations.

4. Director Overboarding (Global)

Under current US policy, ISS may withhold votes from individual directors who sit on more than five public company boards (or are CEOs of public companies who sit on the boards of more than two public companies besides their own, in which case ISS will withhold votes on the outside boards). This year's survey asks for additional insight into views about director overboarding on a global level, noting that global standards on overboarding vary. Where local best practice codes and recommendations provide upper limits for board mandates beyond which directors would be considered overboarded, ISS policies generally apply these limits already. However, the survey poses these additional questions:

Where no such local limits exist, which of the following best represents your organization's view of potential "overboarding" with respect to non-executive directors?

- *Six total board seats is an appropriate maximum limit.*
- *Five total board seats is an appropriate maximum limit.*
- *Four total board seats is an appropriate maximum limit.*
- *A general limit should not be applied, each board should consider what is appropriate and act accordingly.*
- *It depends/other (please specify)*

Where no local limits exist, which of the following best represents your organization's view of potential "overboarding" with respect to directors who serve as CEOs?

- *Three total board seats (including the "home" board where the director is CEO) is an appropriate maximum limit.*
- *Two total board seats (including the "home" board) is an appropriate maximum limit.*
- *A general limit should not be applied, each board should consider what is appropriate and act accordingly.*
- *It depends/other (please specify)*

Pearl Meyer Observation: While this question appears to be aimed at the global level, it is possible that ISS is seeking input in an effort to tighten its US standards (i.e., decrease the threshold on overboarding limits).

Suggested Next Step for Clients

We do believe that through its survey process, ISS is open to understanding the views of public companies on various positions and carefully reviews the results prior to making changes in its proxy voting policies. Therefore, it's very important that our clients participate in the survey process and we are happy to discuss these issues with you.

About the Author

Deb advises on executive compensation from a legal and regulatory perspective, including securities disclosure, tax and governance matters, contract negotiation, and reasonableness opinion letters.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.